LEBANON REAL ESTATE SECTOR

BETWEEN THE SLOWDOWN OF ACTIVITY GAUGES AND THE RELATIVE RESILIENCE OF PRICES

TABLE OF CONTENTS

Executive Summary	1
Residential Market Trends	2
Retail Market Trends	10
Office Market Trends	10
Market Outlook	13

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- **Property market slowing down further within domestic and regional uncertainties**
Amidst growing domestic and regional uncertainties, Lebanon's investment climate extended its sluggishness with market players adopting a wait-and-see attitude. Property sales figures are reflecting a consolidation phase following years of frenetic activity. The value of real estate transactions posted a mild 1.0% yearly rise in the year 2012 and an 8.2% yearly drop during the first half of 2013. More particularly, sales figures show the steady retreat of foreign investors, with the number of sales to foreigners posting declines of 8.9% in 2012 and 8.6% in this year's first half.

- **Smaller sized lodging and properties outside Beirut faring better in the slowdown phase**
Demand for residential lodging in Lebanon continued to be concentrated in more affordable, smaller sized properties and in regions outside Beirut. The capital, which used to account for 37% of property transactions in 2007, represented a much lower 25% during this year's first half. In parallel, larger apartments exceeding 400 square meters have witnessed a slump in demand, whereas small-sized apartments continued to sell, albeit at a slower pace. Those sales are owed to Lebanese residents mostly, as Arab nationals and Lebanese expatriates are more hesitant to invest for the time being.

- **Demand from Syrian refugees supporting rental market**
Demand from Syrian refugees provided a support to the rental market, as they were looking for a temporary stay in Lebanon. Such a demand partly compensated for the lower touristic demand for furnished apartments and mid-scale hotels. While demand from foreigners working in multinationals in Lebanon decreased relative to the previous few years, Syrian demand managed to uplift rental demand for smaller one and two-bedroom apartments across several Lebanese regions.

- **Residential market supply underlined by slowdown in construction sector**
The total area of new construction permits, a leading indicator of current and especially forthcoming construction activity, showed a continued path of decelerating activity on the supply side. Construction permits posted annual drops of 11.7% in 2012 and 14.2% in the first five months of 2013 and their breakdown reflects the gradual shift of developers to smaller sized lodging. Indeed, the 2012 figures show that close to 52% of new residential permits were aimed at apartments of up to 150 square meters, against a lower 44% in 2010, the last realty boom year.

- **Prices still sticky on the downside notwithstanding some occasional discounts**
The slowdown in realty market activity has not been accompanied by a similar correction in prices. The latter have remained on the overall mostly stable since the end of 2010. Within this context, buyers are taking more time to choose and compare offerings, with the real estate market turning into a buyer's market. But what has changed relative to the boom years is that due to lower sales and the prolonged delicate politico-security conditions, some developers have been more prone to granting occasional discounts to serious clients, with these estimated by Ramco Real Estate Advisers in the 5%-10% range.

- **Relatively stable retail and office market activity driven by local demand**
The retail market, largely driven by local demand, has demonstrated some resilience to adverse politico-security conditions in Lebanon, with the somehow defensive food and beverages (F&B) segment ensuring steady demand. Demand for office space was also mainly limited to that stemming from local entities, while multinational companies have somewhat shied away from the market as a result of the regional and local instabilities seen in the past couple of years.

- **Real value in Lebanon's property market in the long term**
Over the past three years, Lebanon's real estate sector has become more competitive on an international scale, as the stability in domestic prices has been coupled with rising international realty prices as economies gradually recovered from global crisis woes. Within this context, in the event of a gradual alleviation of overall pressures tied to the regional turmoil, Lebanon can witness again the emergence of its dormant external demand and a concomitant streak of long term growth in prices within an international arena that is set to increasingly see price gains under a global recovery scenario.

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RESIDENTIAL MARKET TRENDS

Extended property demand slowdown amid tough domestic and regional conditions

The residential property market has been witnessing a practically continuous slowdown since the beginning of the year 2011, on the back of domestic and regional factors. First, the local politico-security climate began to deteriorate towards end-2010 against the backdrop of rising tensions between political factions amidst government resignations, conflict generating domestic issues and few security drifts. Second, the regional environment was subjected to an unexpected turn of events with the start of the Arab Spring in general and the Syrian turmoil in particular which created an overall sluggishness to the overall investment environment in neighbouring countries and in Lebanon.

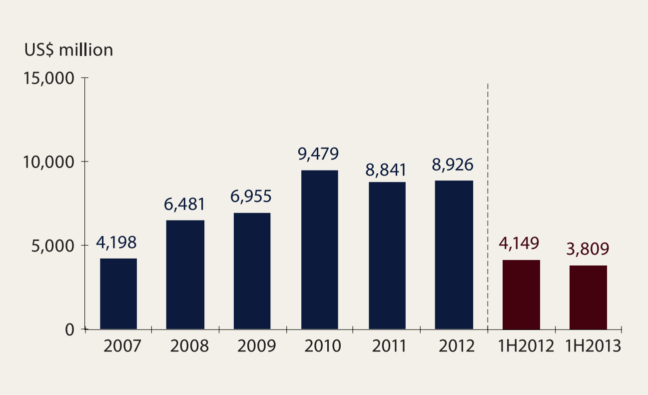
When tensions spread to Lebanon's immediate neighbours, the domestic investment climate indeed deteriorated, with market players adopting a wait-and-see attitude. GCC States issued warnings to their nationals against visiting Lebanon by fear of violence outbreak, and this started having adverse effects on the domestic scene, first and foremost at the level of tourism but also at the level of appetite for realty investments on behalf of foreigners, which had been quite active in the domestic realty market in Lebanon's 2007-2010 boom years. Lebanese expatriates, who usually like to purchase residences in their home country to have a permanent foothold during their rather frequent visits, started refraining from purchases, awaiting further clarity at the level of overall political and security conditions.

This all came at a time when market fundamentals were no longer indicating an undervaluation of the Lebanese realty prices. As a matter of fact, prices had already caught up with international market benchmarks and the local market was attempting to getting accustomed to new and higher price levels which had become somewhat disconnected from the purchasing power of Lebanese residents.

Within this context, residential property demand slowed down and sales figures started to reflect a new reality for the Lebanese realty market, one of a consolidation phase following years of frenetic activity. According to official statistics, the total value of real estate transactions in Lebanon, the bulk of which is residential market-aimed, posted a mild 1.0% yearly rise in the year 2012 from a relatively low base in 2011, year during which they had dropped by 6.7% from 2010 levels in the immediate aftermath of the Arab Spring. Property transactions continued to register a yearly drop of 8.2% during the first half of 2013.

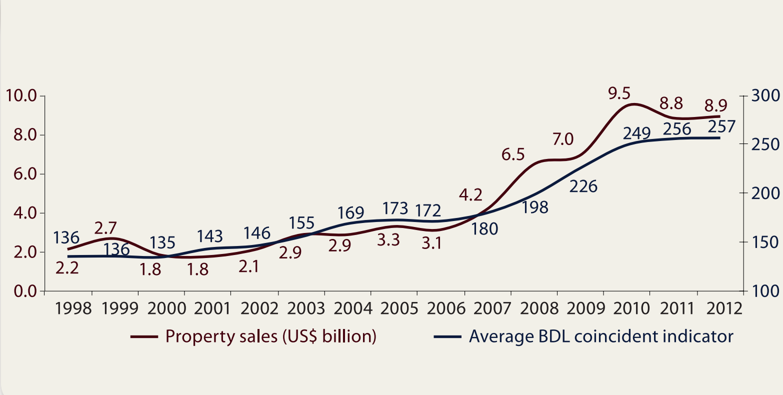
It is worth mentioning that the total value of transactions remains one of the most adequate gauges of market activity on the demand side given its very high correlation with the BDL's average coincident indicator, a synthetic index measuring economic activity in the country. Our regression analysis linking the latter and the transactions value over the past decade and a half, shows a very high correlation of about 96% between the two variables.

PROPERTY SALES TRANSACTIONS VALUE



Sources: Real Estate Registry, Bank Audi's Group Research Department

PROPERTY SALES V/S AVERAGE COINCIDENT INDICATOR



Sources: Real Estate Registry, BDL, Bank Audi's Group Research Department

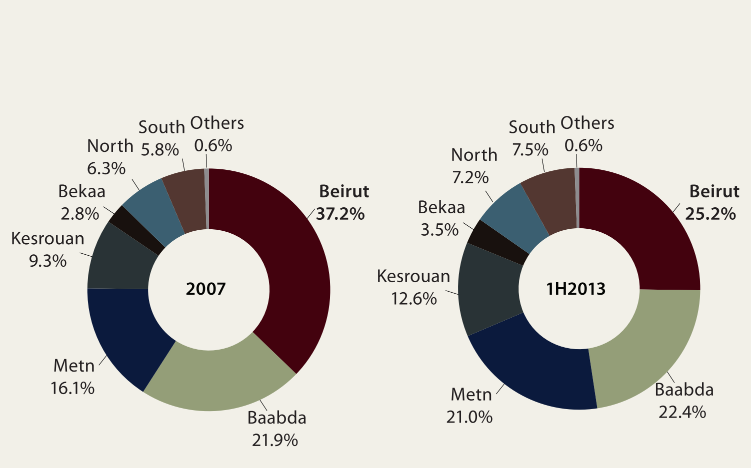
Similarly, the total number of sales transactions continued to point out to a deceleration in property market activity, registering a 10.1% drop in 2012 following another similar drop of 11.9% in the previous year. So far in 2013, property sales transactions declined by a further 7.1% in the first half. More particularly, sales figures show the steady retreat of foreigners from the Lebanese realty market, with the total number of sales to foreigners posting declines of 8.9% in 2012 and 8.6% in this year's first half, after having already dropped by 20.3% in the year 2011. Furthermore, it seems that pre-sales have diminished, with about only 28% of buildings reporting completely sold out units upon the termination of construction works at end-2012, against a much higher share of around 50% before end-2010, as per Ramco Real Estate Advisers.

Smaller sized lodging faring better in the slowdown phase

The Lebanese property market thus seems to be relatively stabilizing following high sales in the previous few years when the market was in a catching up phase amid a normalization of politico-security conditions in Lebanon. But this does not mean that demand has actually vanished. Some market players opted to await positive signals on the political and security fronts, while others continued their hunt for properties. Those mostly consist of Lebanese residents looking to acquire a residential property to actually live in it, whether newlyweds in an immediate need for lodging, or even growing families moving to a bigger or newer house.

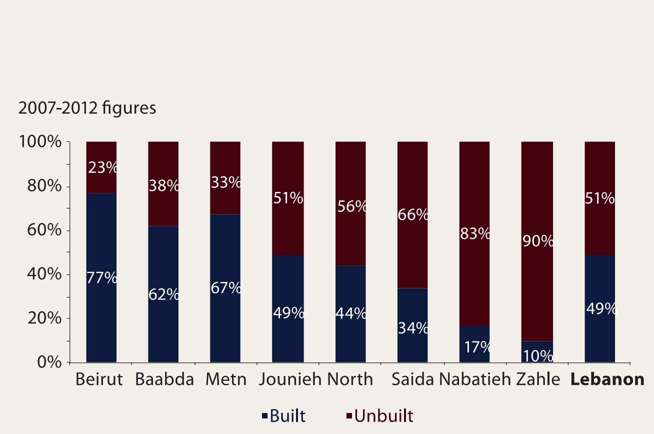
Demand for residential lodging in Lebanon continued to be concentrated in more affordable, smaller sized properties. In fact, larger apartments exceeding 400 square meters have witnessed a slump in demand, whereas small-sized apartments continued to sell, albeit at a calmer and slower pace. Those sales are owed to Lebanese residents mostly, as Arab nationals and Lebanese expatriates came less frequently to the country and are more hesitant to invest, especially as they can afford to postpone their buys until the situation starts improving. Some non-residents or foreigners actually prefer to invest in realty markets abroad or park their funds at banks given the prevailing uncertainties, favouring liquidity over property investments.

PROPERTY SALES TRANSACTIONS VALUE BY REGION



Sources: Real Estate Registry, Bank Audi's Group Research Department

BREAKDOWN OF SALES TRANSACTIONS BY TYPE



Sources: Real Estate Registry, Bank Audi's Group Research Department

But even residents are somehow cautious and think twice before deciding to seal a sales deal, given budgetary constraints and still high prices. Re-sales are more frequent than before in the market, which actually weighed on the number of new apartment sales. As a matter of fact, some speculators or investors who purchased lodging in the boom years or even before decided it is time to book profit, and have realized that price increases, at least tangible ones, are unlikely in the short term. Some have been selling those previously purchased properties at a slightly lower price than the new apartment market, which provides serious buyers with interesting opportunities in the secondary market.

While lodging demand in the capital city is focused on prime and/or emerging residential areas, such as Ras Beirut, Ashrafieh and its periphery, the market is still eyeing slightly farther areas outside Beirut such as Hazmieh, Sin el Fil, Baabda and similar areas surrounding the capital city. Those areas continue to be more affordable than Beirut, and the developing infrastructure linking the capital city to its outskirts has helped demand extend to suburban zones in recent years. The breakdown of real estate transactions value by region shows that Beirut, which used to account for 37% of country-wide transactions in 2007, represented a much lower 25% during this year's first half. Other still less expensive nearby areas such as Baabda and even Metn and the Kesrouan, now gained in market share, representing on aggregate 56% of total transactions value in the first half of 2013, against a lower 47% in 2007.

It is interesting to note that lower sales and the ensuing increase in unsold apartments can also be explained by the fact that a non-negligible part of those properties was launched during the boom years, a period during which developers were to a large extent targeting non-residents or at least larger sized apartment buyers. The more or less rapid change in demand could not be immediately met with a similarly swift shift in supply. While demand mostly from well-off Syrian refugees did manifest in the domestic market, it was not significant enough to act as a driving force for the entire lodging acquisition market.

Rental market favoured by Syrian demand

Syrian refugees actually opted more for renting apartments and were likely looking for a temporary stay in Lebanon until the situation in their home country improves. They somehow compensated for the lower touristic demand for furnished apartments and mid-scale hotels, thus adding support to the rental market over the past couple of years.

This has been a welcomed revival for a market that was actually witnessing some weakness given the preference of residents for apartment purchases and belief in lodging investment with potential gains in the long run, all the more so the local rental market had long been hampered by an obsolete rental law triggering some uncertainties for tenants.

While demand from foreigners working in multinationals in Lebanon decreased relative to the previous few years, Syrian demand managed to uplift rental demand for smaller one and two-bedroom apartments in Beirut and various suburbs, and the Metn area. For landlords, such a demand is beneficial, especially in usually slow winter months.

With the situation in Syria not ameliorating, demand from Syrians is likely to keep some upward pressures on rents in Lebanon. Rents are estimated to have risen by double-digits since the start of violence outbreaks in Syria a couple of years ago.

BOX A: NEW BDL INCENTIVE SCHEME APT TO SUPPORT PROPERTY MARKET FINANCING

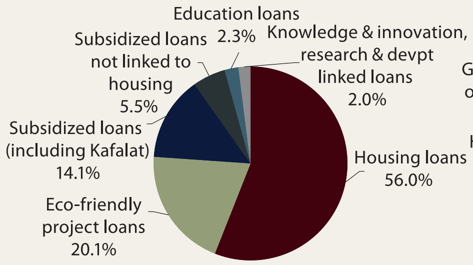
With the property market extending its slowdown of the past couple of years and realty prices still high, the Central Bank of Lebanon has put in place in early 2013 a new incentive mechanism to favour demand for lodging. Following a first round of BDL-subsidized lending in 2009 which spurred demand when the domestic economy was witnessing solid growth rates, the new incentive package comes amid a tough environment both locally and in neighbouring countries, and aims to favour demand for housing at a time of market activity slowdown while maintaining healthy lending growth.

The BDL is lending up to LP 2,200 billion to banks at a 1% interest rate per annum until end-2013. The bulk of this incentive is earmarked for home financing, with around 56% of the total amount allocated to housing loans, as per BDL figures. In details, customer housing loans (BDL 313 not under government protocol) have a ceiling of LP 800 million for the lodging unit to be acquired and which should be a main residence for the borrower, with the BDL covering up to 60% of the total value of the housing loan. Borrowers should not obtain any other banking facilities to cover the value of this housing unit, and the maximum lending period is 30 years. The borrower cannot sell the house acquired through such subsidized loans before seven years time. The interest rate is equivalent to 40% of the one-year LP Tbs yield plus 3.3%.

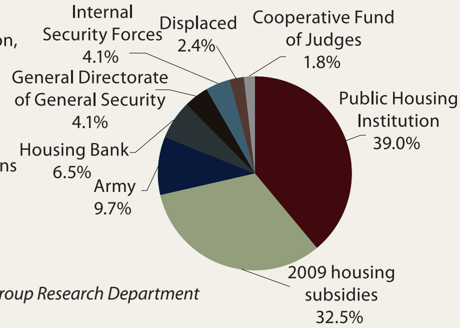
The BDL's new housing scheme is believed to have already increased housing loans demand. Housing loans have seen a remarkable growth over the past few years (41% between end-2007 and end-2012 as per the latest available BDL statistics), albeit from a very low base. As such, the total housing loan portfolio, at US$ 7.3 billion at end-2012, barely represents 15% of utilized loans in the financial sector and thus leverage is believed to be still relatively low in the property financing market.

Anyhow, this new BDL incentive for spurring housing loan demand is likely to have positive spillovers on the broader economy, which is also one of the BDL's objectives through this incentive. Higher realty demand could provide developers with further liquidity and contribute to creating job opportunities and supporting economic activity in corollary sectors.

Breakdown of BDL's LP 2,200 billion scheme



Housing loans under BDL's new program



Sources: BDL, Bank Audi's Group Research Department

Property sector financing

US$ million	2007	2008	2009	2010	2011	2012
Property sales transactions	4,198	6,481	6,955	9,479	8,841	8,926
o.w. Built property estimate	2,207	3,318	3,367	4,542	4,089	4,219
Housing loans portfolio	1,322	1,768	2,805	4,511	5,982	7,269
New housing loans	184	446	1,037	1,706	1,471	1,287
Avg lending ratio	8.3%	13.4%	30.8%	37.6%	36.0%	30.5%
Avg self financing ratio	91.7%	86.6%	69.2%	62.4%	64.0%	69.5%

Sources: Real Estate Registry, BDL, Bank Audi's Group Research Department

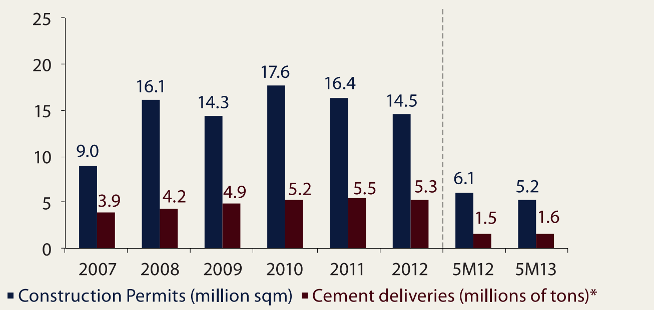
Residential market supply steadily adapting to demand for smaller sized units

With the market slowing down on the demand side, it was normal that developers become increasingly hesitant regarding launching new projects, especially that investors are adopting a wait-and-see attitude during this delicate period the country is going through. According to figures released by the Order of Engineers of Beirut and Tripoli, the total area of new construction permits, a leading indicator of current and especially forthcoming construction activity, showed a continued path of decelerating activity on the supply side. As a matter of fact, after contracting by 6.8% in 2011 from a high base in the previous year, construction permits posted further annual drops of 11.7% in 2012 and 14.2% in the first five months of 2013.

Not only is new construction activity slowing down as of late, but the developers are actually adapting to new demand dynamics. With the market seeking smaller sized flats, some developers have modified existing projects to cater to new demand patterns and sub-divided their areas into slightly smaller ones when possible. Some others opted to launch directly much smaller sized apartment projects than their usual previous ones and, as such, the market started having a wider choice of smaller surface flats, be it in the already quite expensive capital city or its immediate and sometimes less immediate surroundings.

The breakdown of construction permits provided by the Order of Engineers of Beirut (excluding figures from the North) continue to show that the bulk of supply is aimed at the residential market with around 80% of new construction permits earmarked for residences over the 2007-2012 period. More importantly, those statistics also reflect the gradual shift of developers to smaller sized lodging in the country. Indeed, the 2012 figures show that close to 52% of new residential permits across all areas in Lebanon (except the North) were aimed at apartments of up to 150 square meters, against a lower 44% in 2010, the last realty boom year. Residences with areas exceeding 300 square meters accounted for only 13% of the total in 2012.

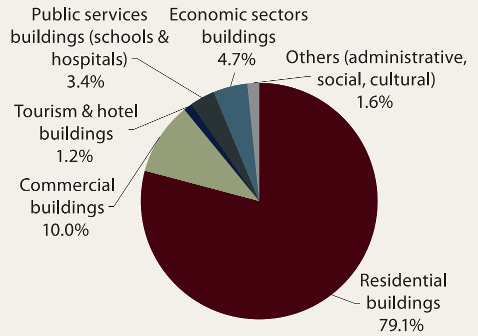
CONSTRUCTION PERMITS & CEMENT DELIVERIES



* Cement deliveries data covers the first four months of the years 2012 and 2013

Sources: Order of Engineers of Beirut and Tripoli, BDL, Bank Audi's Group Research Department

CONSTRUCTION PERMITS (AREA) BY USAGE PURPOSE (2012)



Sources: Order of Engineers of Beirut, Bank Audi's Group Research Department

Similarly, cement deliveries, an indicator coinciding with construction activity, echoed the slowdown mood in the market. Following healthy growth rates in the boom years, their progression decelerated in 2011 (+6.2%, possibly reflecting cement needs for projects already launched) before regressing by 4.4% in 2012 and nudging up quite mildly (+3.5%) over the first four months of 2013 as per BDL figures. It is important to note that cement deliveries are also very highly correlated with overall economic activity in the country, with our regression analysis run over the past 15 years between cement deliveries and BDL's average coincident indicator showing an 88% correlation between the two variables.

With the supply side feeling the pinch of slowing demand in the country, construction costs decelerated too over the past year and a half, following a rather moderate single-digit growth in 2011. The Audi compiled construction cost index for Lebanon, including various materials and labour prices, registered a relatively mild 3.9% increase in 2012, owed to a quasi-stagnation in materials cost and a double-digit growth in labour costs reflecting the upward adjustment in salaries. During the first half of 2013, construction costs barely stood still (-0.1%), reflecting a quasi-stagnation of both its components, and thus mirroring the overall market mood in a much calmer realty sector than during the boom years.

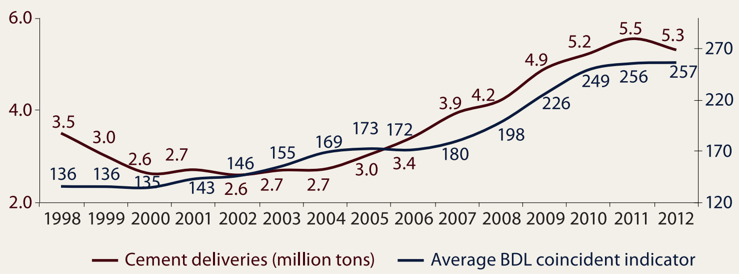
But this does not mean that the capital city or its surroundings are not still getting busy with new construction projects underway. It is just that some new construction stock is adding to that already underway since two or three years. Anyhow, the new construction stock is providing opportunities for prospective buyers and increasing their lodging choice on top of unsold units in already finished buildings. The new reality in the market is driving developers to adopt a relatively slower pace of construction, at least as long as the existing building oversupply is gradually sold.

NUMBER OF CONSTRUCTION PERMITS FOR HOUSING UNITS

	2010	Structure	2011	Structure	2012	Structure
Less than 100 sqm	1,695	6.4%	1,853	7.4%	1,504	6.8%
101 - 150 sqm	10,053	37.9%	11,573	46.0%	9,938	45.0%
151 - 200 sqm	7,201	27.2%	5,735	22.8%	5,401	24.4%
201 - 300 sqm	4,046	15.3%	2,771	11.0%	2,386	10.8%
301 - 400 sqm	503	1.9%	505	2.0%	345	1.6%
More than 400 sqm	543	2.0%	279	1.1%	151	0.7%
Individual houses	1,426	5.4%	1,583	6.3%	1,464	6.6%
Villas	1,036	3.9%	863	3.4%	914	4.1%
Palaces	1	0.0%	6	0.0%	5	0.0%
Total	**26,504**	**100%**	**25,168**	**100%**	**22,108**	**100%**

Sources: Order of Engineers of Beirut, Bank Audi's Group Research Department

CEMENT DELIVERIES V/S AVERAGE COINCIDENT INDICATOR



Sources: BDL, Bank Audi's Group Research Department

Residential prices holding mostly still despite some occasional discounts

The slowdown in realty market activity has not been accompanied by a similar correction in prices. The latter have remained on the overall mostly stable since the end of 2010, with the smaller sized segment faring rather better. But what has changed relative to the boom years is that due to lower sales and the prolonged delicate politico-security conditions, some developers have been more prone to granting occasional discounts to serious clients, with these estimated by Ramco Real Estate Advisers in the 5%-10% range on average.

Given the overall stability in prices at close to their 2010 levels, buyers are taking more time to choose and compare offerings on the market. They are evidently becoming pickier and residential real estate has turned into a buyer's market. Developers have become somewhat more flexible in recent months, although they try to maintain their prices as long as possible despite the slowdown in sales. The negotiation process is taking longer than it used to, and some buyers might get occasional discounts. The secondary market, as mentioned earlier, has witnessed slightly lower prices with some investors booking profits on property purchased a few years ago.

Residential prices in Lebanon are relatively sticky on the downside. One of the main reasons behind this is land prices. Land is in fact an important component of end-user prices, alongside construction costs and developers' margins. The domestic realty market has been witnessing a relatively steady demand for land in a small country where fewer empty plots are available. This cannot easily provoke downward pressures on end-user prices.

Land estate is widely believed to be a rather safe investment haven. Some developers are still looking for potentially lucrative opportunities despite the cautiousness of buyers and the still uncertain domestic environment, but are not willing to acquire land plots at any cost and are increasingly cautious especially as land prices have reached high levels. Land price movements usually differ between one area and the other, but in some cases can prove somehow disconnected from the evolution of residential prices. Investors looking to park their funds into realty are more active in this market segment, and believe in the long-term value of land and/or the price appreciation potential. In this sense, the impact of such investments on new residential projects underway is likely to remain contained to a certain extent as those plots are not aimed at building new projects.

Add to this that realty demand in the country is mostly driven by end-users who are in genuine need for lodging and are not looking to make a quick buck and exit their investments but rather occupy themselves the properties they purchase. Furthermore, developers are not considerably leveraged, and rely on self-financing or pre-sales much more than on bank debt when embarking on new projects. As such, they are not necessarily in a hurry to close a sales deal and sell at any price. They tend to stick to their asking prices as much as possible as they do not have significant debt dues to settle. As a result of such structural factors, residential realty prices have a tendency to be quite sticky on the downside.

Besides, it is worth adding that some new real estate taxes planned to help finance the new public sector wage scale were approved by the government and transferred to Parliament for discussion. Those consist of a series of property and construction-related fees and taxes to cover forthcoming expenditures, such as a 15% property capital gain tax (with the exception of original residence and inherited property) with capital gains reduced by 8% for each year of holding and with full exemption for a holding period of above 12 years, notwithstanding an exceptional one-off revaluation during the year that follows the law approval, subject to revaluation taxes of 6% of capital gains. Some developers expressed concern that such measures might lead to upward property price pressures at large.

The government is also mulling a new draft law to raise the plot ratio of buildings and allow developers to increase the built-up area of environment-friendly projects, thus providing additional revenues to the government to help fund the new public sector wage scale. For buildings in zones where a maximum of four floors can be constructed, the built-up area increase by up to 25% would be equally broken down over those four floors. For buildings in other zones, an additional floor will be allowed for construction but should not exceed the top floor area.

BOX B: LEBANON AMONG NET IMPROVERS IN 2012 REAL ESTATE TRANSPARENCY INDEX

Lebanon emerged as a net improver on a global scale between 2010 and 2012 according to Jones Lang LaSalle's 2012 Global Real Estate Transparency Index, with the market gaining transparency. The index aims to help real estate investors, corporate occupiers, retailers and hotel operators understand important differences when transacting, owning and operating in foreign markets. It is updated every two years and broken down into five categories that address factors affecting real estate transparency: investment performance, market fundamentals, listed vehicles, regulatory and legal environment and transaction process. The Transparency Index scores range on a scale from 1.00 to 5.00. A country or market with a perfect 1.00 score has total real estate transparency; a country or market with a 5.00 score has total real estate opacity.

While the pace of improvement in the MENA region has been slower than that seen in other parts of the world between 2010 and 2012, Lebanon emerged as an exception, posting the most significant progress amongst 15 markets within this geography and proving the ninth top improver amongst the 97 global markets included in the survey. Coming in the 66th position, Lebanon's real estate market moved from a classification of low transparency in 2010 to another one of semi-transparency in 2012. With a score of 3.75 out of 5.00, Lebanon's transparency level surpassed that of the MENA region which recorded an average of 3.89 out of 5.00.

Jones Lang LaSalle said that the Lebanese market is gaining more structure and attracting attention from institutional players as a result of strong activity a few years ago, with high land prices in Beirut. The level of market information and public interest in the realty sector has risen significantly, as per the same source. Besides the BDL's stringent rules on loans allocated to the sector, the Real Estate Association of Lebanon is implementing other improvements in transparency by better regulating the brokerage industry. However, while transparency may be moving forward, Jones Lang LaSalle did not rule out the potential threat stemming from instabilities affecting the Lebanese market.

Real Estate Transparency 2012 - Composite Index, Middle East & North Africa

Transparency Level	2012 Composite Rank	Market	2012 Composite Score
Semi	47	UAE - Dubai	3.05
	52	UAE - Abu Dhabi	3.23
	63	Bahrain	3.62
	64	Saudi Arabia	3.63
	66	Lebanon	3.75
	67	Kuwait	3.76
Low	72	Qatar	3.82
	74	Oman	3.85
	76	Morocco	3.88
	77	Egypt	3.88
	80	Jordan	3.97
Opaque	89	Tunisia	4.38
	91	Iraq	4.44
	93	Algeria	4.49
	97	Sudan	4.59

Sources: Jones Lang LaSalle, Bank Audi's Group Research Department

RETAIL MARKET TRENDS

Ongoing demand sometimes facing landlords' high rental prices

Lebanon's retail market has long been known to demonstrate some resilience to adverse politico-security conditions, with the somehow defensive food and beverages (F&B) segment ensuring steady demand from companies operating in the sector and seeking retail space. Most retail hotspots in the country, and specifically in F&B dominated areas such as Mar Mikhael and some parts of Hamra, are faring rather well and continue to witness demand for retail space. But some segments of the retail market in Lebanon are seeing landlords continuing to ask for high rental prices and tenants hesitating to engage in rental contracts at those prices they sometimes deem as too elevated, according to Ramco Real Estate Advisers, especially given the slower economic activity and the drop in the number of tourists.

In some cases, landlords are granting occasional discounts and have been showing a relative flexibility by consenting to lower values in the aim to align offers with aspirations of the market. In quite a few others, they are sticking to their price levels of the past couple of years and are finding difficulty in replacing tenants or having a new tenant rent their retail space. On the overall, rents have been to a certain extent stable though some discounts have been granted by a few landlords, as per the same source.

Verdun, which had established itself as a prime retail area and saw its retail activity peak in the past few years, has seen some landlords stick to high rents and thus witnessed a rising time frame to re-lease certain outlets, though the area remains in demand with companies looking for retail space but in some cases not agreeing to landlords' offers, as per the same source. Notwithstanding the current environment, Verdun is awaiting the US$ 200 million ABC Verdun mall by 2017 which is expected to modernize the retail landscape in the area and provide buyers with a one stop shop for a variety of retail articles.

The retail landscape in Hamra continues to reflect that of a busy area. There are fewer retail spots available for rent relative to some other regions of the capital city, with F&B outlets and retail brands supporting demand. Hamra street occupancy rates are very high with retail spots very much sought after. Just a few spots in the entire area are available, and might reflect landlords sticking to asking prices and tenants seeking to settle for lower values.

In the Beirut Central District, the Beirut Souks, the Foch, Allenby and South Uruguay areas are doing relatively well with a concentration of retail activity in those areas, and Zaytunay Bay remains trendy, though a couple of spots there have experienced a change of tenants in recent times. Yet, some other less visible retail spots in the BCD have been seeing vacancies extend, particularly the Maarad Street which witnessed multiple business shutdowns.

In the outer areas of the capital city, Hazmieh has recently benefited from the inauguration of Majid Al Futtaim's City Center, attracting many retailers from around the world. The US$ 350 million Beirut City Center, developed by Dubai-based Majid Al Futtaim, has opened its doors to the public. The new mall includes over 200 stores which extend over 60,000 square meters of retail space. The owner and operator of the mall is also seeking approval for a 175-room hotel opposite the City Center.

OFFICE MARKET TRENDS

Rather stable market driven by local demand

Demand for office space is being limited to that stemming from local entities, while multinational companies have somewhat shied away from the market as a result of the regional and local instabilities seen in the past couple of years. In the context of a frail politico-security environment, the office segment has been to a certain extent affected by the prudent attitude exhibited by firms seeking to rent or even buy office space at landlords' sometimes high rental prices which mostly stuck to their previous years' levels. Rental rates were more or less sticky on the downside, with occupancy rates reaching 75%-80% in the Beirut Central District and more or less similar levels in other prime areas in the capital city, namely Ashrafieh, Hamra and Verdun, as per Ramco Real Estate Advisers.

In the Beirut Central District, which remains to date the first business destination in town with high occupancy rates on the overall, small and medium sized offices are still attracting tenants while larger ones are struggling to be rented. On the overall, there is a current stock of circa 30,000 square meters waiting to be sold, as per Ramco Real Estate Advisers. In fact, offices available in the market do not meet the demand as they mainly consist of larger units ranging between 400 and 700 square meters while companies exhibit more interest in units with sizes ranging between 100 and 200 square meters and which can be rented at a more reasonable price.

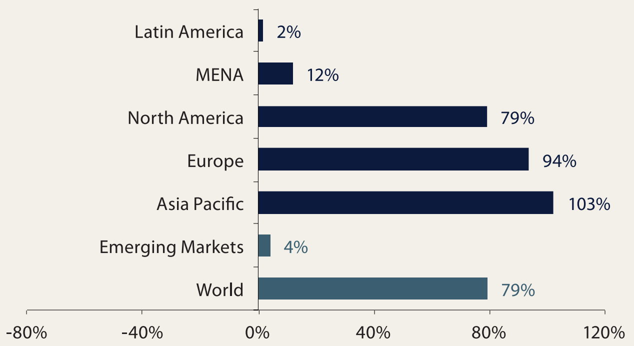
Hamra's ageing stock is mainly occupied by local companies, with rents more accessible than other prime Beirut office areas. It is worth noting that the clinics niche is witnessing a healthy demand, with new projects near the AUB medical center. The upcoming supply comes in response to existing demand primarily interested in smaller sized units. The healthy sales ratio posted by the two projects around AUB medical center is a proof that the performance of the clinics niche remains strong, as per Ramco Real Estate Advisers. Also in the area, the Gefinor center posts high occupancy rates and a rental value among the most expensive in town, as per the same source.

The Ashrafieh area boasts more than 100 office buildings with circa 16 additional ones currently under construction, as per the same source. New supply for office space evident in the south-east periphery of Ashrafieh (Adlieh, Museum and Cornishe Al Nahr) is being met by demand, with a few buildings under construction in comparatively adequate locations benefiting from relatively easy access.

On the outskirts of the Lebanese capital, Sin El Fil has been attracting healthy demand due to its modern stock and its proximity from the capital coupled with the relatively adequate amenities offered. It is gradually becoming an alternative to Ashrafieh for companies looking for office space.

RETAIL RENTS 12 MONTHS TO JUNE 2012

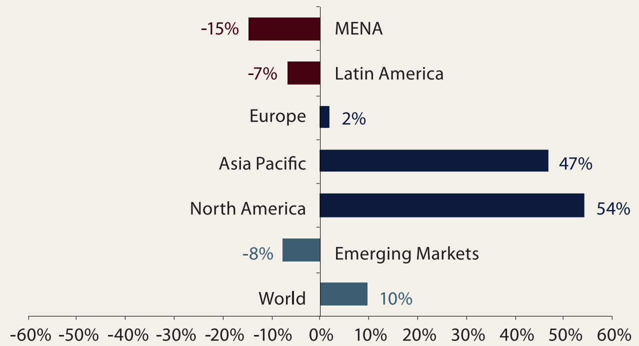
RELATIVE TO PRIME BEIRUT RENTS



Sources: Cushman and Wakefield, Bank Audi's Group Research Department

CENTRAL DISTRICTS OFFICE OCCUPANCY COSTS 2012

RELATIVE TO BEIRUT CBD OCCUPANCY COSTS



Sources: Cushman and Wakefield, Bank Audi's Group Research Department

BOX C: SOLIDERE: INVESTMENT CLIMATE SEVERELY AFFECTING 2012 CASH FLOW GENERATION

Solidere sal, Lebanon's leading real estate developer and a regional market player, reported US$ 16.0 million in net profits in 2012, against a much higher US$ 162.6 million in the previous year. Consolidated figures including all associate companies and subsidiaries show net profits of US$ 17 million. Solidere attributed those results to the general economic slowdown and tense political environment in Lebanon and the region, which had a restraining impact on land sales, the investment climate, and commercial activities in general. The 2012 performances are attributed to a slump in revenues from land sales, which reached US$ 49.6 million last year against US$ 241.7 million in 2011, given the lack of investment appetite within this environment. Solidere still managed to display some positive results, notably at the level of rental revenues which rose by 8.9% year-on-year to attain US$ 54.3 million.

Within the current economic environment, Solidere pursued its efforts to streamline and decrease its operating and general and administrative expenses. The company said it succeeded in realizing a tangible and continuing drop in general and administrative expenses (-1.6% on a yearly basis), adding that said drop would have been much more important if it wasn't for the mandatory wage increase.

The 2012 bottom line figures were further burdened by exceptional provisions amounting to US$ 19.2 million, and consisting of US$ 10 million reflecting weakened touristic and entertainment activities' performances, and which adversely hit company investments in this field, and US$ 9.2 million for various other expenditures.

During the year 2012, Solidere spent about US$ 40 million on cash dividends, US$ 18 million on infrastructure, US$ 27 million on the North Souks, specifically in the Cineplex, entertainment center and Khan Antoun Bay, US$ 23 million on various new real estate developments, and US$ 44 million on taxes and various other fees.

Solidere continues to benefit from high market value assets with an inventory of land available for sale and/or for development of about 1.87 million square meters worth of built-up area and valued at about US$ 8 billion based on current market prices. Liquidity levels remain notable, with US$ 149 million in cash and a portfolio of accounts receivables resulting from land sales activities of close to US$ 553 million. The company boasts low leverage ratios, with bank loans and facilities at only 36% of total equity or 7% of the market value of total assets. As such, these indicators reflect Solidere's ability to weather current conditions and move on the remaining infrastructure program and various real estate activities, as per company releases.

The company said that given the prevailing uncertain conditions and to counteract current and future challenges resulting from the economic slowdown, it will continue to prioritize and re-schedule its various activities to preserve liquidity and ability for sustainable operations, while continuing with its planned infrastructure activities, especially in the waterfront area.

Solidere Developments

Status	Projects	BUA (sqm)	% of total area
Completed	270	1,385,800	45.0%
Under restoration	6	12,543	0.4%
Under construction	49	524,044	17.0%
Awaiting permit	23	371,448	12.1%
Under study	25	359,324	11.7%
No activity	7	16,632	0.5%
Awaiting submission	14	407,835	13.3%
Total	**394**	**3,077,626**	**100.0%**

Sources: Solidere - 4Q 2012, Bank Audi's Group Research Department

MARKET OUTLOOK

To sum up, the real estate market is set to continue showing contracting sales activity along with stable prices. The price stability confirms the flat phase of the staircase phenomenon that the country has known for decades. Indeed, amidst a non-supportive environment such as the one that we are witnessing nowadays, prices tend to be flat subsequent to upward trends under previous more conducive environments. In few words, prices either rise or stabilize but do not practically decrease in Lebanon.

The theory of price stickiness on the downside is actually tied to three main factors in Lebanon, namely the quasi absence of speculation, the low leverage and the scarcity of land. First, speculation in Lebanon is considerably limited, estimated at less than 20% of market transactions, which means that threats of market collapse as a result of investors retreating from the market is limited given the dominant share of end-users. Second, leverage is relatively limited, which leaves developers under no pressure to decrease their prices in a sluggish environment as they are not pressurized by debt redemption. Third, given the scarcity of land in Lebanon, resilient land prices provide a continuous support to housing prices at large.

Looking forward, the signs of a more or less sluggish summer activity, with more forgone tourists and less incoming of Lebanese expatriates are not encouraging for the real estate sector. The market is set to extend further the wait-and-see attitude, namely at the level of the external demand that usually accounts for 30% to 40% of total demand. It is actually the domestic component of demand that is witnessing the most considerable resilience, with no less than 14,000 housing units demanded by residents on the basis of 900,000 resident households in Lebanon growing at circa 1.5% per annum.

On the other hand, though market volumes have declined recently, the stagnation of prices since early 2011 should incite buyers that have delayed purchases to materialize them given that prices are not decreasing. Having said that, the stagnation of prices is also increasing and likely to increase further the share of end-users at the detriment of speculative investors that generally benefit from price fluctuations.

An issue of growing importance is that of Syrian demand for Lebanese realty. Some Syrians are increasingly finding in Lebanon's real estate sector a safe haven for their savings. As prospects for the Syrian crisis look continuously dim, such a demand is likely to persist for a while, helping somehow to provide a cushion to the Lebanese real estate market. It is worth mentioning that Syrians target readily available apartments to live in immediately while the bulk simply rent apartments. Such a Syrian demand is increasingly felt outside Beirut, in the direct suburbs and in the mountains.

In the long term, there is definitely value in Lebanon's realty market. It is worth mentioning that over the past three years, Lebanon's real estate sector has become more competitive on an international scale, as the stability in domestic prices has been coupled with rising international realty prices as economies gradually recovered from global crisis woes. Within this context, in the event of a gradual alleviation of overall pressures tied to the regional turmoil, Lebanon can witness again the emergence of its dormant external demand and a concomitant streak of long term growth in prices within an international arena that is set to increasingly see price gains and where Lebanon has lagged behind in relative terms over the past few years.

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